Economic Outlook

Irving Trust

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The tone of the economy seemed to shift dramatically during the first half of 1985. Several indicators reported early in the year pointed to an improvement in the economy, but the improvement proved ephemeral, as the economy subsequently displayed more extensive weakness than earlier data had indicated. Real GNP growth in the second quarter, however, has likely accelerated significantly compared to the first quarter's paltry rise. Substantial drops in interest rates during the past few months make it all the more likely that the economy will grow at a more normal rate during the remainder of 1985.

The economy appears to be at a critical juncture. Several industries are undergoing painful adjustments, while consumer confidence seems fragile, ready to reflect any adverse economic developments. The declines in interest rates during the last few months indicate that the Federal Reserve has been concerned that the chance for a pickup in economic activity might slip away without its active support. While these declines in rates have enhanced the prospects of a turnaround, they also reflect the seriousness of the economic and financial strains felt in the United States and elsewhere.

Revisions in economic statistics are routine, but their direction and extent can influence the general perception that economic conditions are improving or deteriorating. Such has been the case so far this year. In late March, the "flash" forecast for real GNP in the first quarter showed annualized growth of 2.1%. As more complete data became available in following months, the estimates of real GNP growth in the first quarter were subsequently revised to 1.3% in April and 0.7% in May. Compared to some prior quarters, these are not particularly large revisions. Nevertheless, they seemed to reinforce the emerging perception that the economy was weaker than had been anticipated.

The first quarter's sluggish growth primarily reflected a dramatic surge in imports accompanied by a drop in exports. Excluding net exports, real growth rose at a moderate 4.0% annual rate. Since it is unlikely that the trade deficit will become enlarged during the second quarter at the same rate as during the first, it will be much less of a drag on growth than it was in the first quarter. In addition, although housing starts have been rising since last fall, real GNP in the first quarter did not benefit from a rise in residential investment, which will contribute to growth in the second quarter. Moreover, despite erratic month-to-month movements, the pattern of retail sales indicates that consumer spending is staying on a course of moderate growth.

It is possible that tax reform may lead to a spurt in certain types of activity later this year followed by a temporary falloff early in 1986. For example, under any tax reform proposal presented so far, it would be advantageous for a taxpayer who itemizes to purchase a car in 1985 rather than in 1986 in order to benefit from the current sales tax deduction. In addition, firms may decide to purchase equipment to be placed in service in 1985 rather than in 1986 to take advantage of the current investment tax credit, which seems a likely casualty of tax reform. In any case, prospects for a pickup in growth over the rest of this year appear good.

Bernard Schoenfeld

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Economic Forecast

Percent Changes at Annual Rates

	Actual	1985				Forecast 1986				Actual 1983-	1984-	Forecast 1985-
	I	II	III	IV		I	II	III	IV	1984	1985	1986
Gross National Product	6.4	7.8	9.4	8.9		9.1	6.1	7.3	8.7	10.8	7.5	8.2
Real GNP	0.7	4.5	4.8	4.1		4.0	1.4	2.0	3.0	6.8	3.3	3.4
GNP Price Deflator	5.6	3.2	4.3	4.6		4.9	4.6	5.2	5.5	3.8	4.0	4.7

	Actual 1985: I	Forecast 1985:II	Actual 1983-1984	Forecast 1984-1985	Forecast 1985-1986
Consumer Spending	8.5%	8.3%	8.6%	7.7%	8.4%
Durable Goods	10.5	10.7	13.9	8.8	8.6
Nondurable Goods	5.0	6.5	6.9	5.1	7.8
Services	10.6	9.0	8.5	9.4	8.9
Business Capital Spending	7.0	10.1	20.6	11.3	8.8
Structures	19.8	16.5	16.0	16.2	9.8
Equipment	0.5	6.5	23.4	8.7	8.2
Residential Investment	4.8	22.0	16.4	6.8	6.3
			1984	1985	1986
Change in Inventories	$40.6b.	$40.0b.	$58.2b.	$46.4b.	$58.3b.
Net Exports of Goods and Services	$-69.1b.	$-81.0b.	$-64.2b.	$-86.0b.	$-105.9b.
			1983-1984	1984-1985	1985-1986
Government Purchases	4.4%	8.5%	9.0%	9.1%	8.1%
Federal	1.5	9.3	9.5	11.4	7.7
Defense	3.4	10.0	10.5	10.0	8.5
Other	-3.9	7.5	6.7	15.7	5.5
State & Local	6.5	8.0	8.7	7.6	8.3
Corporate Profits Before Tax	-7.9*	-3.6*	16.0	2.2	6.2
Corporate Profits After Tax	-7.0*	-1.4*	14.5	3.2	6.2
Plant and Equipment Expenditures	4.4	16.1	16.0	9.2	7.1
Real Final Sales#	0.1	4.5	5.0	3.5	3.1
Real Disposable Personal Income	-1.7	5.0	6.7	3.1	3.4

Economic Indicators	Recent Data Mar.	Apr.	May	Actual 1983-1984	1984-1985	Forecast 1985-1986
Consumer Price Index**	6.0%	4.8%	n.a.	4.3%	4.1%	5.0%
Producer Price Index for Finished Goods**	2.4	3.6	n.a.	2.1	3.1	5.0
Industrial Production	3.6	-2.4	n.a.	10.6	3.2	3.8
Retail Sales##	-0.2	2.4	-0.8	10.5	7.0	6.7
				1984	1985	1986
Auto Sales (millions of units, a.r.)	10.7	11.1	11.3	10.4	10.8	10.2
Housing Starts (millions of units, a.r.)	1.88	1.91	n.a.	1.75	1.79	1.68
Unemployment Rate	7.3%	7.3%	7.3%	7.5%	7.2%	6.8%
Merchandise Trade Deficit (a.r.)	$132.6b.	$142.2b.	n.a.	$123.3b.	$148.0b.	$160.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

June 13, 1985

#GNP less change in inventories, both in real terms.
##Monthly percent changes are not annualized.
*Year-over-year percent changes.
**Annual percent changes are December to December (not seasonally adjusted).

$b. = billions a.r. = annual rate F = Forecast